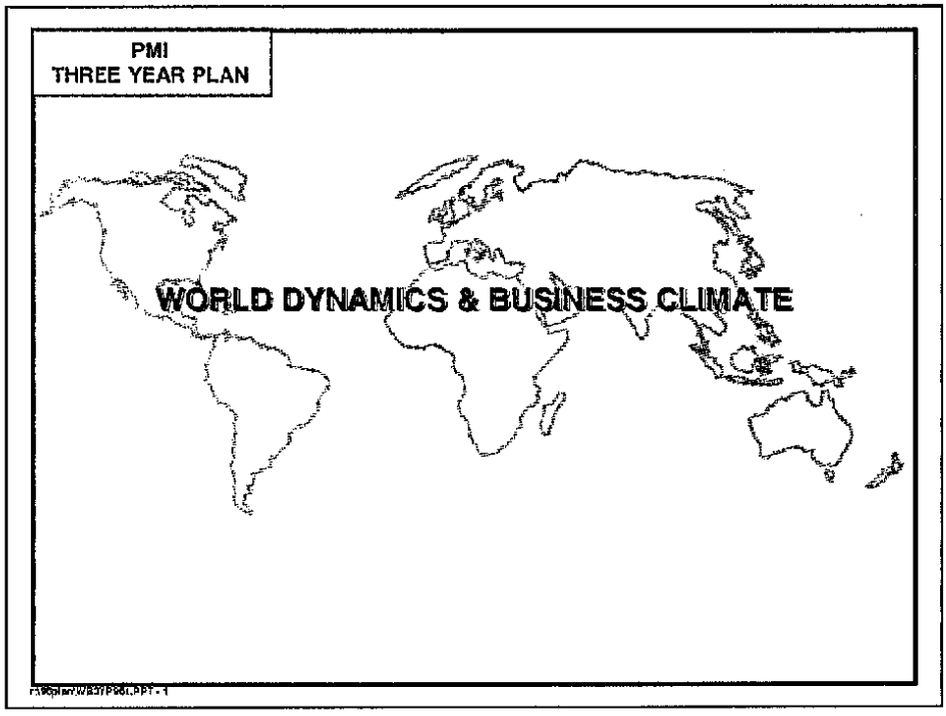

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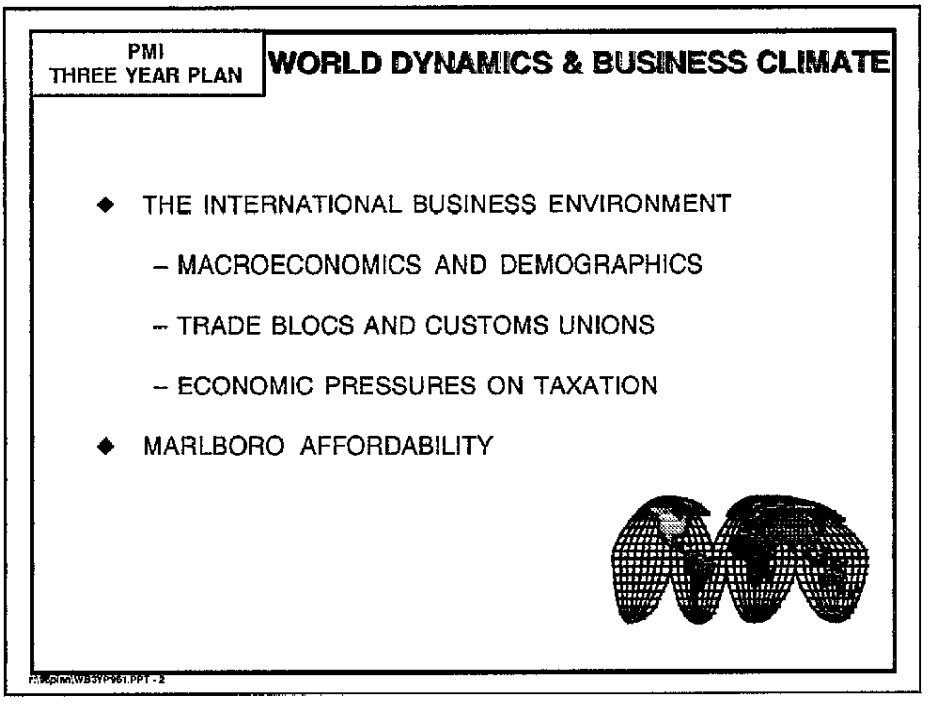

- In this section I will try to place our plan in the context of the international business environment. We'll briefly review macroenonomics and demographics, trade blocs and worldwide pressures to raise taxes. We'll conclude the section with a brief look at Marlboro's affordability.

- Turning first to inflation.

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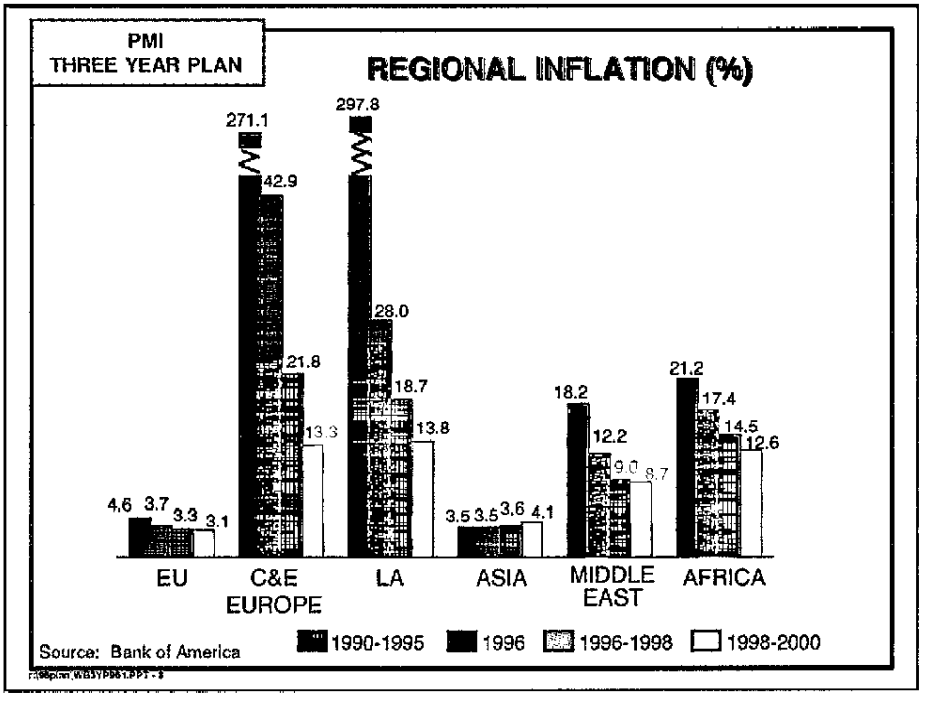
Source: https://www.industrydocuments.ucsf.edu/docs/jgpx0003



- First, looking at inflation rates across the world ,we are facing sharply declining inflation rates over the next five years. Asia is the only regional exception, where inflation is projected to be slowly increasing.
- Inflation has implications on our ability to raise prices.
- Given PMI's business mix, and all else being equal, declining inflation rates in Western Europe, Central & Eastern Europe and Latin America can be expected to exert downward pressure on our IFO growth.
- Turning now to GDP growth.

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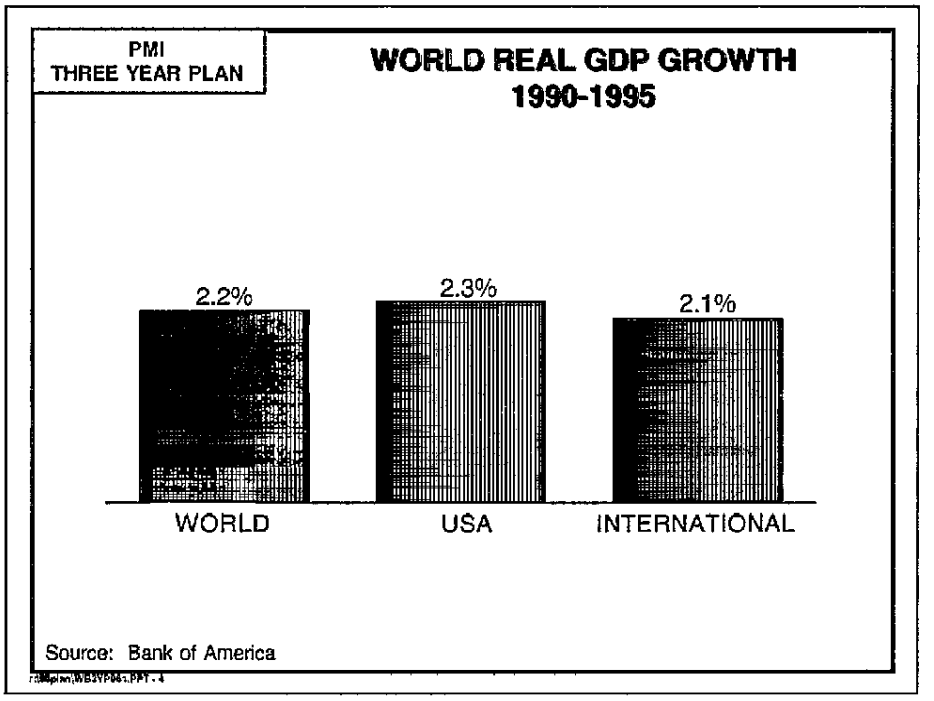
Source: https://www.industrydocuments.ucsf.edu/docs/jgpx0003



- Over the last five years, World GDP has been growing in real terms at 2.2% per annum, with the USA and International growing at approximately the same rate.

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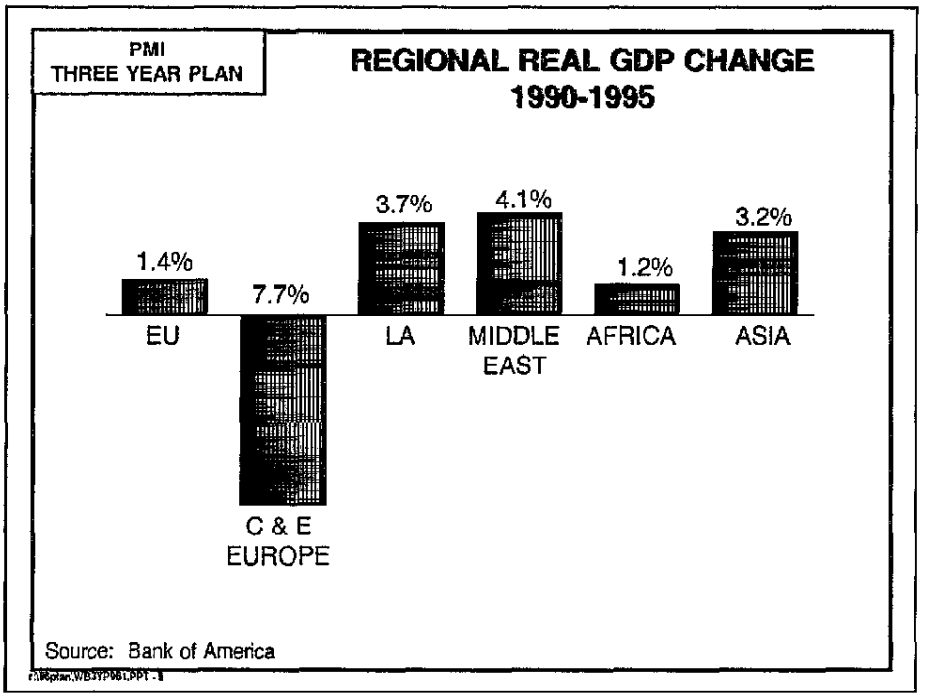
Source: https://www.industrydocuments.ucsf.edu/docs/jgpx0003



- This chart shows real GDP change in our major regions from 1990 to 1995. Over the last five years, real GDP has been growing in Latin America, the Middle East and Asia, while stagnating in Western Europe and Africa. Central and Eastern Europe in particular went through tremendous structural changes during which the economies have been suffering.

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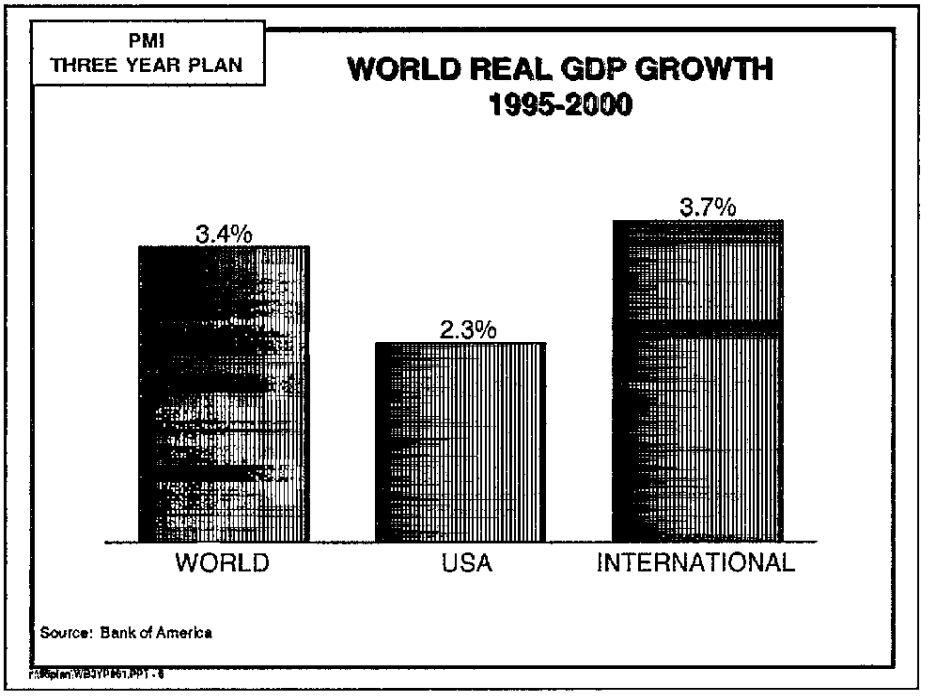
Source: https://www.industrydocuments.ucsf.edu/docs/jgpx0003



- Over the next five years, world GDP is projected to grow at a faster rate of 3.4% per annum in real terms. This faster rate will be entirely due to International which will grow at 3.7%. We estimate the USA will grow at the same average rate as in the past five years.
- Let's look at what this means for PMI's regions.

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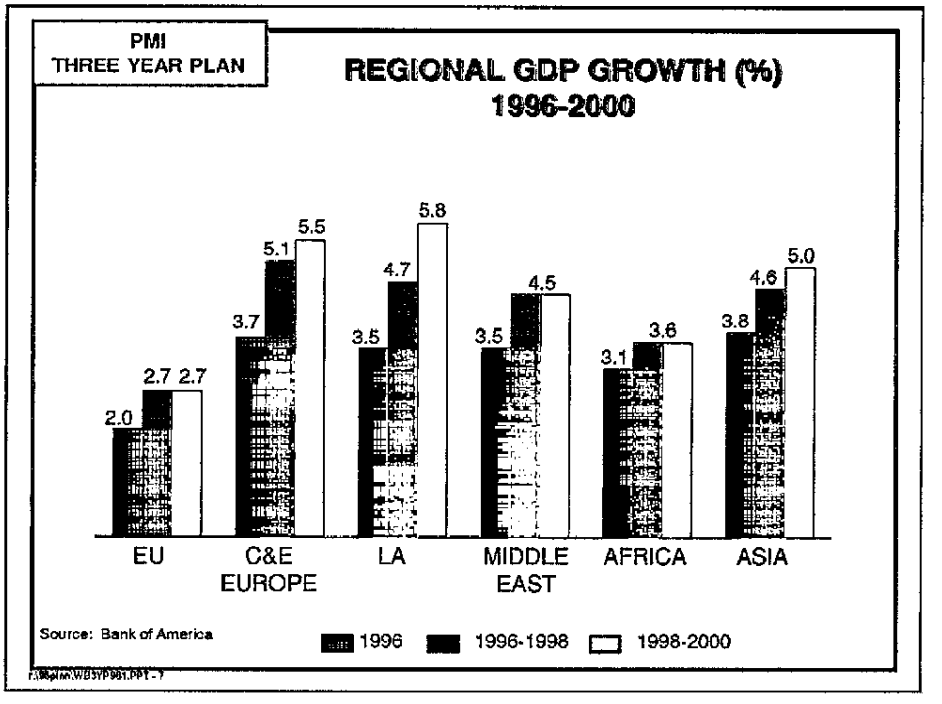
Source: https://www.industrydocuments.ucsf.edu/docs/jgpx0003



- Here you can see the regional trends for the next 5 years. The red bars represent real GDP growth in 1996, the blue the last two years of the plan period to 1998, and the yellow, 1998 to 2000.

- We are looking at faster economic growth across all regions with the fastest growth coming in the latter years of the plan and beyond.

- Peak increases in real GDP should come from the Central & Eastern Europe, Latin America and Asia regions.

- The richer people feel, the easier it is for them to buy PM's premium priced products.

2073449031

Source: https://www.industrydocuments.ucsf.edu/docs/jgpx0003

PMI
THREE YEAR PLAN

SHARE OF TOTAL WORLD GDP*

	1990	1995	2000
INTERNATIONAL	77%	77%	80%
USA	23%	23%	20%

* GDP AT PURCHASING POWER PARITY

Source: WEFA

- With the improvement in economic growth already outlined, international markets should be increasing their share of world GDP over the next five years, from 77% to 80%.

2073449032

Source: https://www.industrydocuments.ucsf.edu/docs/jgpx0003

PMI
THREE YEAR PLAN

SHARE OF TOTAL WORLD GDP (%)

		1990	1995	2000
DECREASING	W. EUROPE	25	23	21
	JAPAN	9	8	8
STABLE	MIDDLE EAST	3	3	3
	AFRICA	4	4	4
	C&E EUROPE (EX-RUSSIA)	1	2	2
INCREASING	CHINA	6	9	11
	OTHER ASIA	13	14	16
	LATIN AMERICA	8	9	9
	RUSSIA	5	2	3
	TOTAL INTERNATIONAL	77%	77%	80%

Source: WEFA

- In this chart, we have grouped together broad regions and countries in terms of low growth, world average growth, and high growth areas.
- PMI's high IFO yielding established markets are estimated to be the slowest growing markets, with a declining share of world GDP.
- The Middle East , Africa, and Central and Eastern Europe, excluding Russia, are projected to grow at around the average world rate.
- The major growth areas should be China, Asia, Latin America, and Russia - the latter turning around following a period of transition.

2073449033

Source: https://www.industrydocuments.ucsf.edu/docs/jgpx0003

PMI
THREE YEAR PLAN

COMPETITIVE BALANCE OF POWER

	LATIN AMERICA	WESTERN EUROPE	C & E EUROPE	ME & AFRICA	JAPAN	ASIA & AUSTRALIA	TOTAL INT'L.
SHARE OF GDP							
CHANGE TO 2000	0.3	(1.9)	-	0.1	(0.5)	4.2	2.1%
MARKET SHARE %							
PM	24.2%	32.6%	21.8%	13.8%	15.5%	2.3%	11.8%
BAT	50.5%	8.3%	13.2%	15.6%	5.2%	7.3%	11.7%
OTHER MAJOR INT'L.	2.9%	22.7%	19.9%	19.7%	79.0%	3.2%	13.9%
OTHER/LOCAL	22.4%	36.4%	45.1%	50.9%	0.3%	87.1%	62.6%

- This chart shows competitive market shares across the regions, and compares where our and BAT's strongholds are.

- BAT's International volume is expected to be neck-and-neck with ours for 1995.

- We are strong relative to BAT in the established, but lower growth Western European markets, in Japan and in Central & Eastern Europe. However, BAT is stronger in the fastest growing Asia region and in Latin America.

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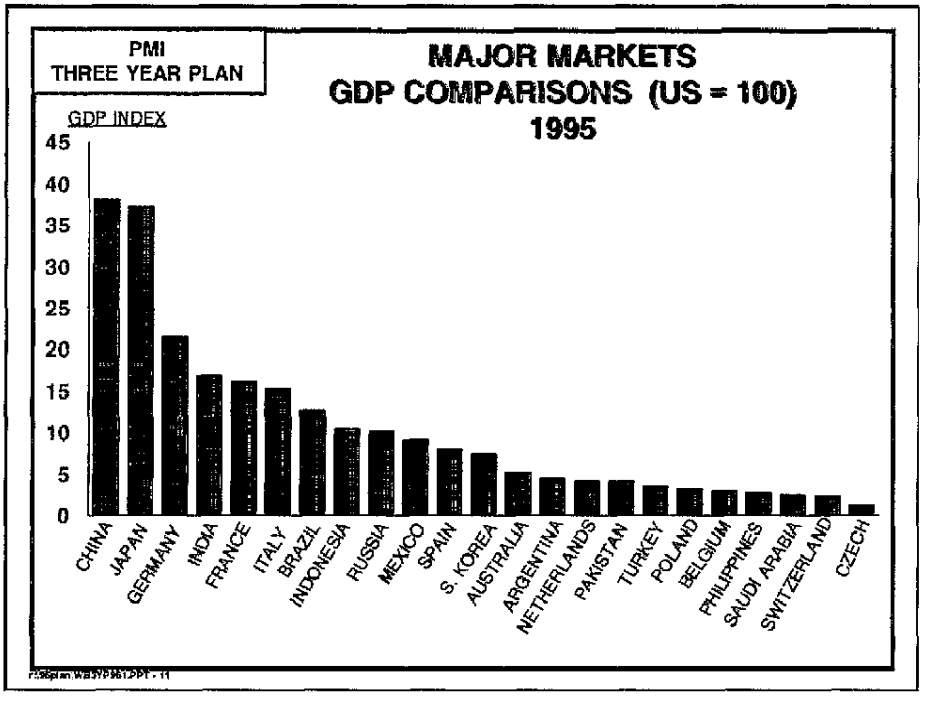
Source: https://www.industrydocuments.ucsf.edu/docs/jgpx0003



- In this chart, we have ranked twenty major markets in terms of the relative size of their economies and versus the USA. We have also added China, India and Pakistan. China is the second largest economy in the world after the USA.

- These markets represented close to three quarters of total PMI volume in 1995, and should grow further in importance through the plan period.

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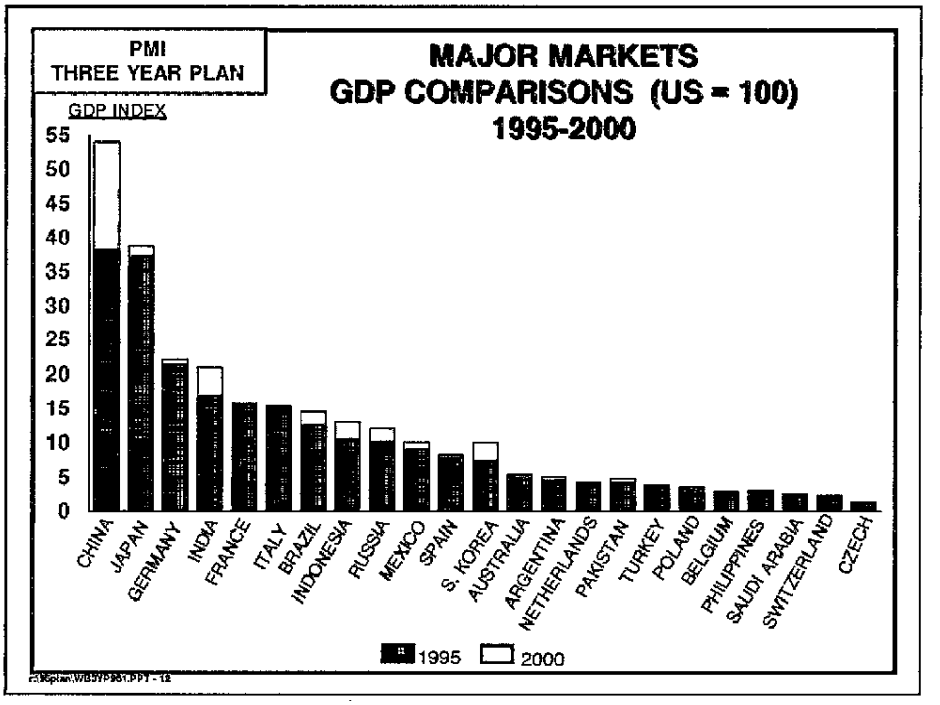
Source: https://www.industrydocuments.ucsf.edu/docs/jgpx0003



- Over the next five years, China, India, Brazil, Indonesia, Russia, and South Korea are projected to be the fastest growing economies.
- PMI has established a good presence in Russia, and is making good progress in S. Korea. The other areas we need to work on.

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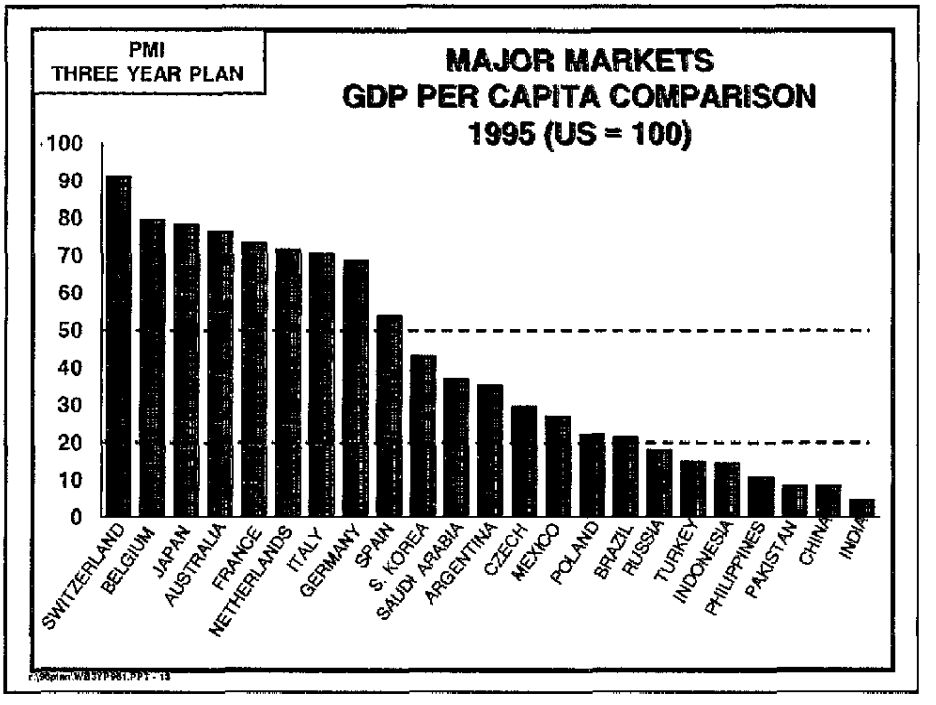
Source: https://www.industrydocuments.ucsf.edu/docs/jgpx0003



- In terms of GDP per capita versus the USA, Switzerland has the highest standard of living after the USA.

- We can broadly group these major countries in terms of established, first tier developing and second tier developing economies. In terms of PMI 1995 volume, these markets split 37% established (colored blue), 15% first tier developing (colored green), and 21% second tier developing (colored red) to comprise a total 73% of our total volume.

- By contrast, the established markets shown here contributed 61% of our total market IFO in 1995. By 1998, these markets will contribute 57%.

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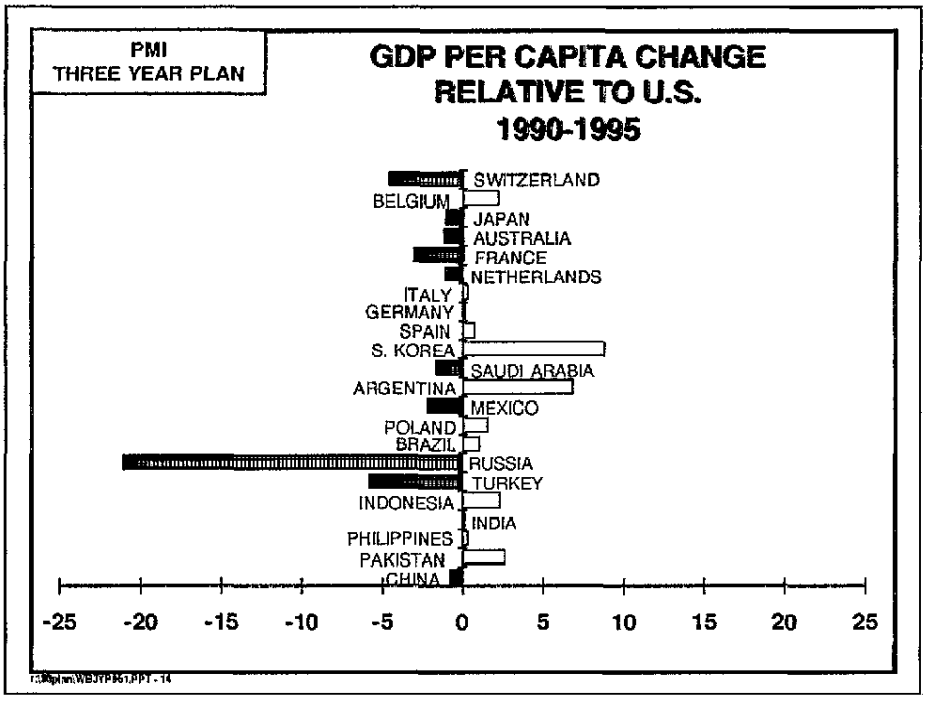
Source: https://www.industrydocuments.ucsf.edu/docs/jgpx0003



- Let's now look at the changes in the GDP index for our major markets relative to the US from 1990-1995, and then through the year 2000 to illustrate major standard of living changes.

- Over the last five years, from 1990-1995, these countries have been a mixed bag of improving and stagnating or declining economies.

- Russia and Turkey, in particular, stand out in terms of declining living standards, while South Korea and Argentina have been improving significantly.

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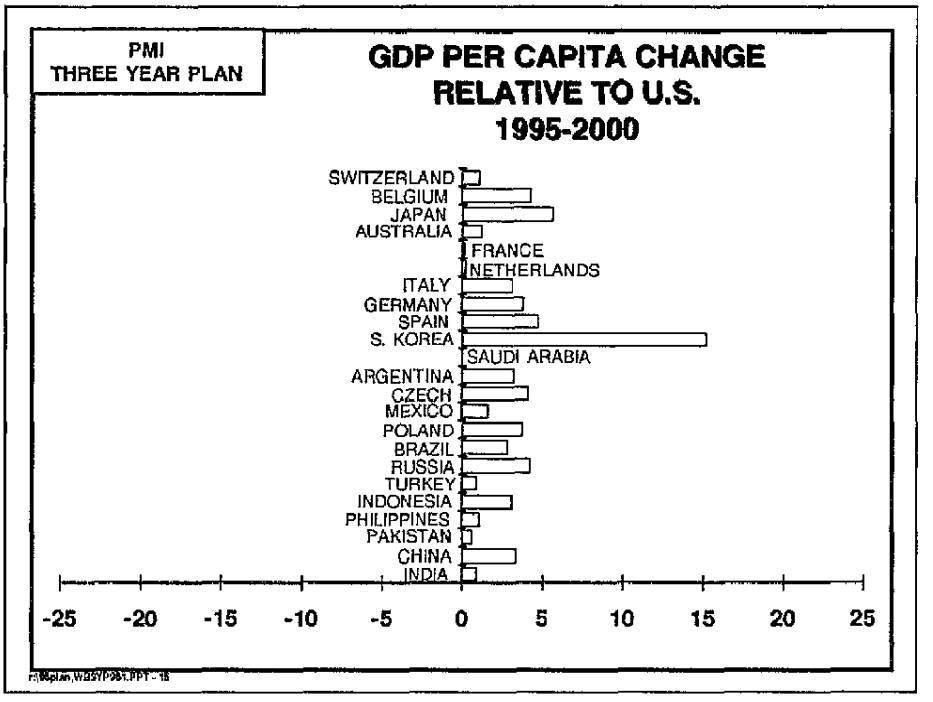
Source: https://www.industrydocuments.ucsf.edu/docs/jgpx0003



- By contrast, over the next five years, virtually all these countries should show significant improvements in living standards, with only France, Netherlands and Saudi growing at around the US rate. South Korea in particular stands out. The increases in GDP per capita for the developing countries is significant, because they come off a low base.

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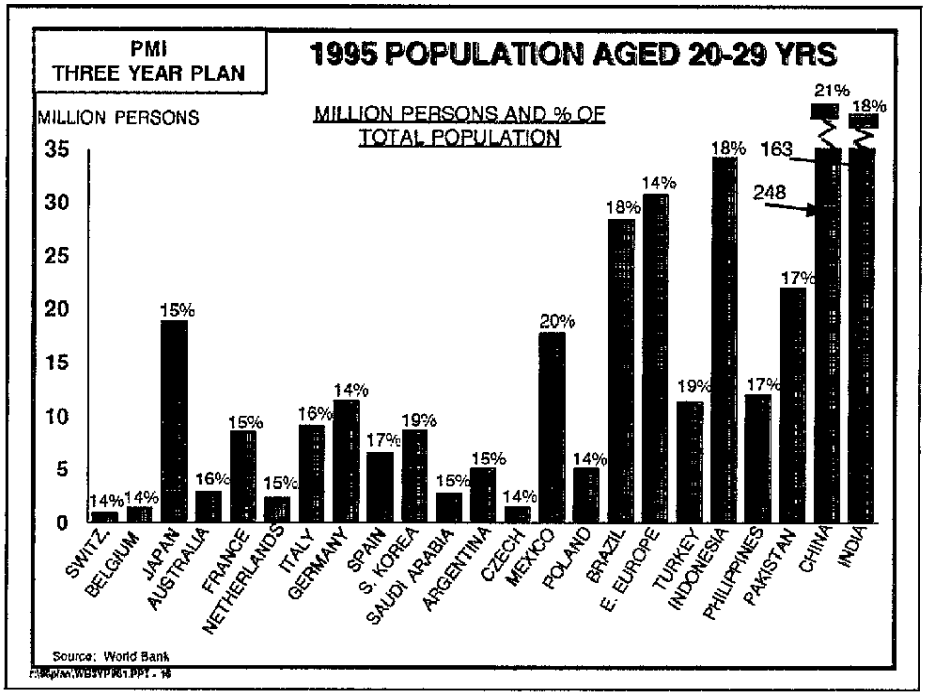
Source: https://www.industrydocuments.ucsf.edu/docs/jgpx0003



- Turning now to look at the demographics, of particular importance to the growth of our business, is the trend for the 20-29 years age group.
- This chart shows the size of the population aged 20-29 years for the major markets together with the percentage of the total population it represents.
- About 70% of the 5.4 billion international population live in these countries as does close to 70% of the 1.0 billion international population of 20-29 year olds.
- China and India are of course off the scale, with high proportions of their population falling within the 20-29 age group. Mexico, Brazil and Indonesia also catch the eye in terms of both the number of persons in this age group and their % of total population.
- Eastern Europe represented here by our four major markets of Russia, Ukraine, Belarussia and Kazakhstan, is also important in terms of the absolute size of this age group, as is Japan.
- South Korea and Turkey also have large proportions of their population in this age group.

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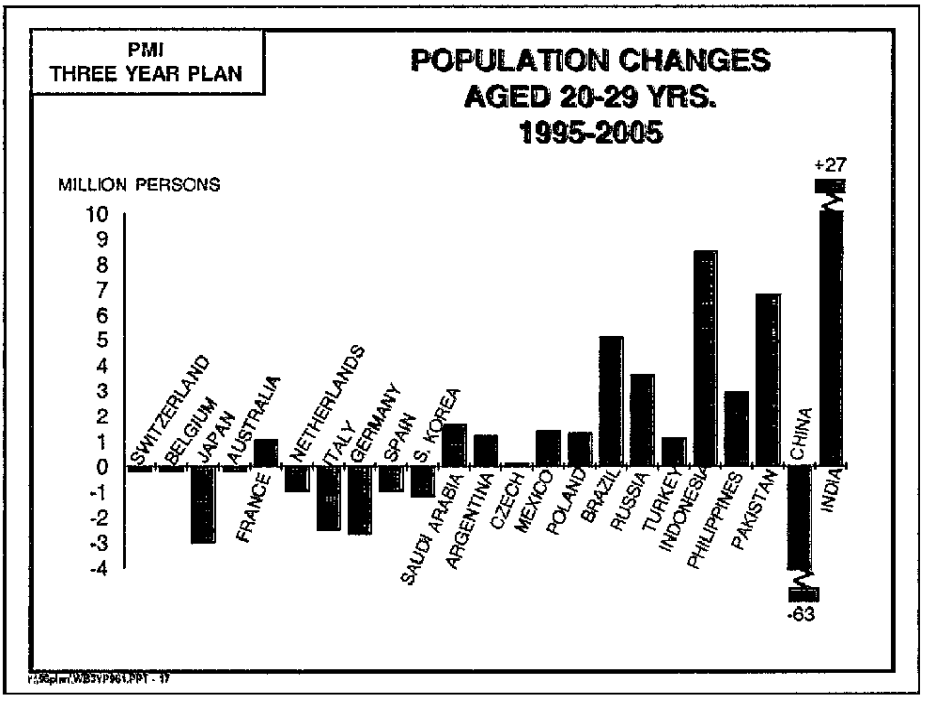
Source: https://www.industrydocuments.ucsf.edu/docs/jgpx0003



- This chart shows the development of the 20-29 year age group over the next ten years. Significant growth will only come in the developing markets, and most particularly in what we have termed the second tier developing markets. Although China's 20-29 year population is sharply declining, the result of its one-child policy, it will still comprise 184 million people in 2005.

- Our established markets, with the single exception of France, will have a declining population within the 20-29 year age group.

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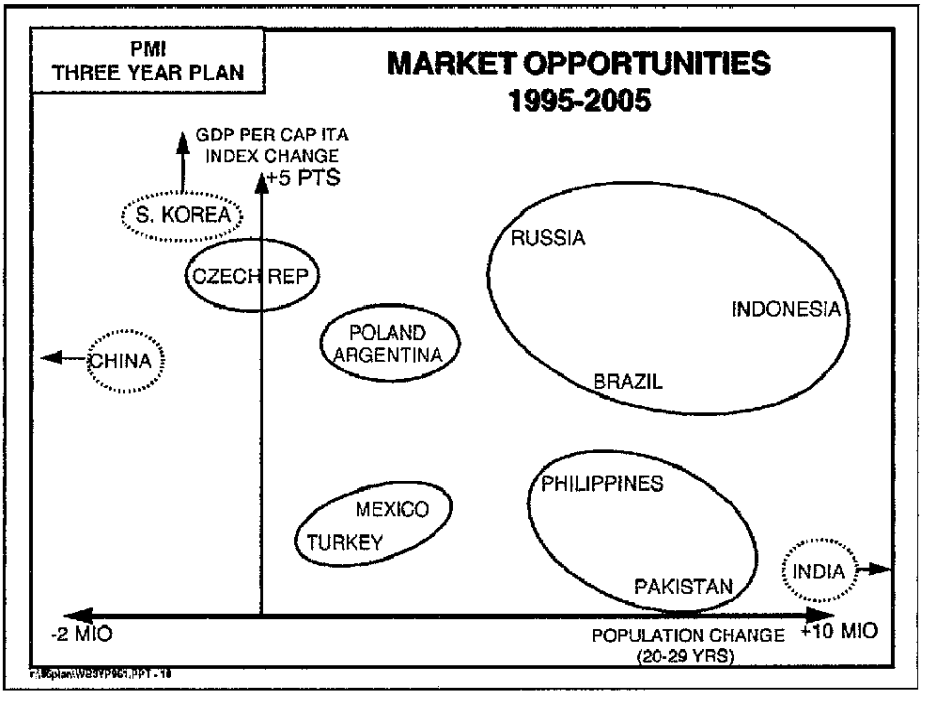
Source: https://www.industrydocuments.ucsf.edu/docs/jgpx0003



- Here we have charted the per capita GDP change vs. the 20-29 year old population.

- For the developing countries, this chart summarizes where we think the major opportunities exist over the next ten years. The countries are color coded in terms of the size of the opportunities. The countries colored red are where there are the greatest opportunities, based on economic development and demographics, with either significant increases in both per capita GDP and in the 20-29 years age group or rapidly improving living standards and economic growth.

- The countries colored green are where there exist significant opportunities.

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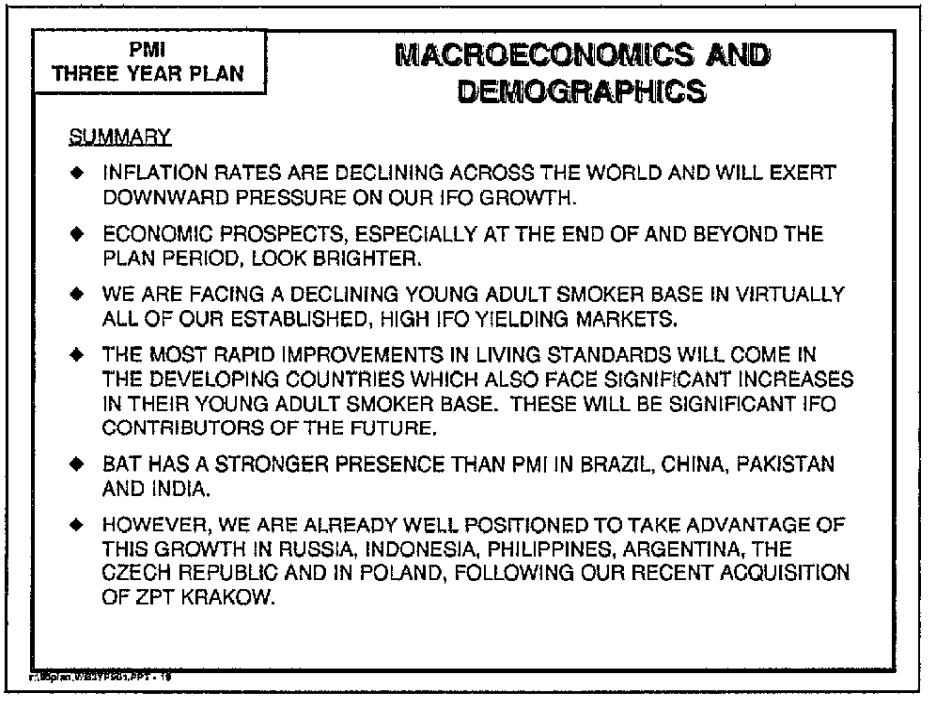
Source: https://www.industrydocuments.ucsf.edu/docs/jgpx0003



- In summary:

  "Read Chart"

2073449042

Source: https://www.industrydocuments.ucsf.edu/docs/jgpx0003

PMI
THREE YEAR PLAN

TRADE BLOCS AND CUSTOMS UNIONS

TRADE BLOCS	REGION	MEMBER COUNTRIES	POPULATION (MIO)	CIGARETTE INDUSTRY VOLUME (BIO UNITS)	PMI SOM%
AFTA	ASIA	MALAYSIA, PHILIPPINES, INDONESIA, THAILAND, VIETNAM, SINGAPORE, BRUNEI	419	373	7%
NAFTA	LA	US, CANADA, MEXICO	385	576	41%
EU	EUROPE	GERMANY, ITALY, FRANCE, SPAIN, UK, NL, BELGIUM, LUX., GREECE, PORTUGAL, SWEDEN, FINLAND, DENMARK, IRELAND, AUSTRIA	371	578	30%

Trade Blocs

- Turning to the regional trade blocs and customs unions that could potentially influence our business.
- In AFTA, member countries have adopted a Common Effective Preferential Tariff (CEPT) scheme, under which tariff rates will be reduced to a maximum of 5% by 2003, but some countries may reach this target by 2000. CEPT covers manufactured goods, including processed agricultural products, with 40% ASEAN content. However, the inclusion of tobacco in tariff preferences is voluntary. AFTA provides the potential for significant duty savings, particularly on processed tobacco exported from our new factory in Malaysia to other member markets. However, tobacco products are on the 'sensitive' list for Malaysia, which means that they are currently exempt from the CEPT scheme. Active lobbying to get tobacco off the sensitive list will continue. Cigarettes, reconstituted tobacco and cut filler/ET all fall under CEPT in Indonesia, Thailand and the Philippines. Vietnam is shaping its policy, and we plan to lobby its AFTA delegates.
- Turning to NAFTA, almost all the Latin American and Caribbean countries have requested membership. Canada's 10% tariff on US tobacco will be eliminated by January 1998, having already been reduced from 20%. Mexico originally had a 20% tariff rate and required import licenses. During NAFTA negotiations, the import license requirement was converted into a tariff and Mexico's base rate was set at 50% for tobacco and cigarettes in 1994 , with a 5%-point reduction per year to eventual elimination in 2004. In 1996, Mexico's tariff stands at 40%. We have opportunities for US export to Mexico.
- In the EU, the plan foresees no shift in the VAT regime from the destination system to the origin system, nor any change in the minimum 15% VAT and the 57% Excise rate. The EU Council remains deadlocked on total ad ban legislation. However, indirect taxation may come under pressure nationally, as it may be used as a tool by member states to reduce public debt in order to comply with the convergence criteria for economic and monetary union. EMU stipulates criteria for inflation, interest rates, currency fluctuations and public deficit/debt. We will return to taxation later. Beyond the plan period, Duty Free is due to be eliminated from 1999, although an extension is being sought, and wider EU membership could impact PMI in terms of taxation and sourcing. From January 1, 1996, Turkey entered into a customs union with the EU.

2073449043

Source: https://www.industrydocuments.ucsf.edu/docs/jgpx0003

PMI
THREE YEAR PLAN

TRADE BLOCS AND CUSTOMS UNIONS

TRADE BLOCS	REGION	MEMBER COUNTRIES	POPULATION (MIO)	CIGARETTE INDUSTRY VOLUME (BIO UNITS)	PMI SOM%
MERCOSUR	LA	ARGENTINA, BRAZIL, URUGUAY, PARAGUAY	204	165	28%
ANDEAN PACT	LA	VENEZUELA, ECUADOR, COLOMBIA, PERU, BOLIVIA	100	47	20%
CEFTA	C. EUROPE	CZECH REPUBLIC, SLOVAKIA, POLAND, HUNGARY, SLOVENIA	66	147	21%

- Within Mercosur, Internal tariffs on cigarettes and tobacco were eliminated at the end of 1994 in Argentina and Brazil , and at the end of 1995 in Uruguay and Paraguay. To benefit from the tariff preferences, products must have 50% of their content originating within Mercosur member countries. Mercosur has a common external tariff (CET) of 20% for cigarettes and 14% for tobacco. Paraguay has not yet adopted the CET, and currently has a tariff rate of 30% for cigarettes. PMI has sourcing options to supply Argentina, Uruguay and Paraguay from Brazil.
- The Andean Pact has progressed beyond a free trade agreement, to implementation of a customs union to coordinate economic and trade policies. Common external tariffs are set at 10% for tobacco and 15% for cigarettes. PMI has opportunities to source both cigarettes and food from lower cost producers. Manufacturing in Colombia for export to other member countries is a possibility.
- CEFTA is primarily a political discussion group, with limited free trade agreements among its member countries. An expansion list of of products to circulate duty free is currently under consideration, but cigarettes are not expected to be included in the near future. PMI is not lobbying in favor, as we already have a strong position in the Czech Republic and Slovakia. The Czech Republic in particular does not want this group to be seen as a single block, as they fear it would delay its EU membership.

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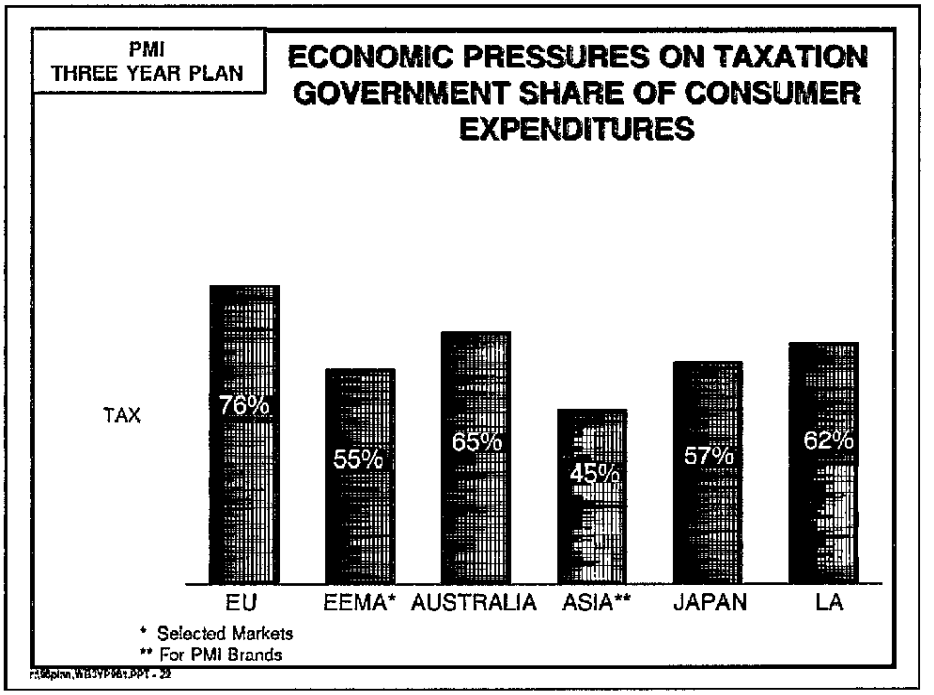
Source: https://www.industrydocuments.ucsf.edu/docs/jgpx0003



- Turning to taxation, this chart shows where the consumer expenditure on cigarettes goes. Between 45% and 76% of consumer expenditure goes to the tax man, the highest figure relating to our highest IFO yielding region, the EU.

- After trade margins, manufacturers get between 16% and 38% of total consumer expenditure in terms of net revenues, the lower figure again relates to our highest IFO yielding region, the EU.

- Any change in indirect tax rates have a significant impact on our IFO.

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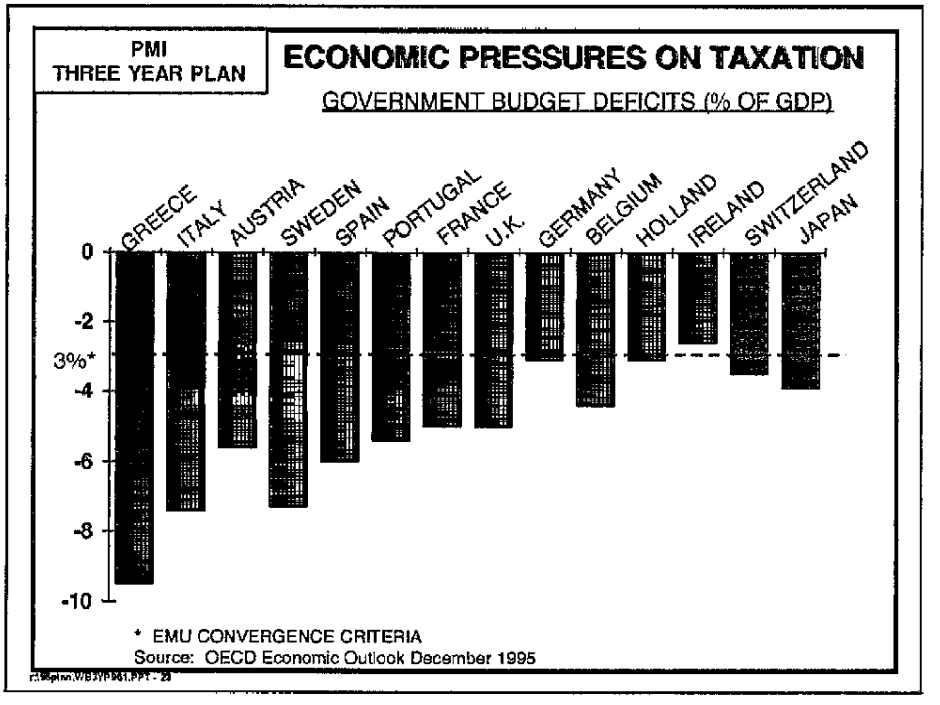
Source: https://www.industrydocuments.ucsf.edu/docs/jgpx0003



- This chart shows the government deficit positions in 1995 for the EU countries, which includes three of our five leading IFO contributors, together with our other two top five IFO contributors, Japan and Switzerland. One of the criteria for EU monetary union is a public deficit of less than 3% of GDP, with compliance to be established on the basis of 1997 economic performance. France and Belgium in particular, both committed to monetary union, have yet to reach compliance. Both have recently raised VAT. France's adverse public reaction to rein in spending programs threatens to lead to tax increases instead. Serious attempts by Italy, the southern member state most motivated to join the monetary union, cannot be ruled out. Other southern states, for example Greece, may not even try to meet the criteria.

- In Japan, there is pressure to increase indirect taxation due to recent income tax reductions and increased Government expenditure following the Kobe disaster. We have included a 2 %-point consumption tax increase in the plan for 1997, but an excise tax increase is also a risk. In Switzerland tobacco taxes are "earmarked" to support pensions, but current taxation meets less than half the continuingly increasing requirement - excise tax increases of twice the rate of inflation are included in the plan.

- In the EU, we have not assumed excise tax increases during the plan period. This constitutes a serious plan risk of nearly $200 million, and is included in our pro/con list.

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Source: https://www.industrydocuments.ucsf.edu/docs/jgpx0003

- Finally, we'll wrap up this macroeconomics section with a brief look at Marlboro affordability across our major markets, in terms of the retail price relative to GDP per capita and in terms of the number of minutes of work required to buy a pack of Marlboro.

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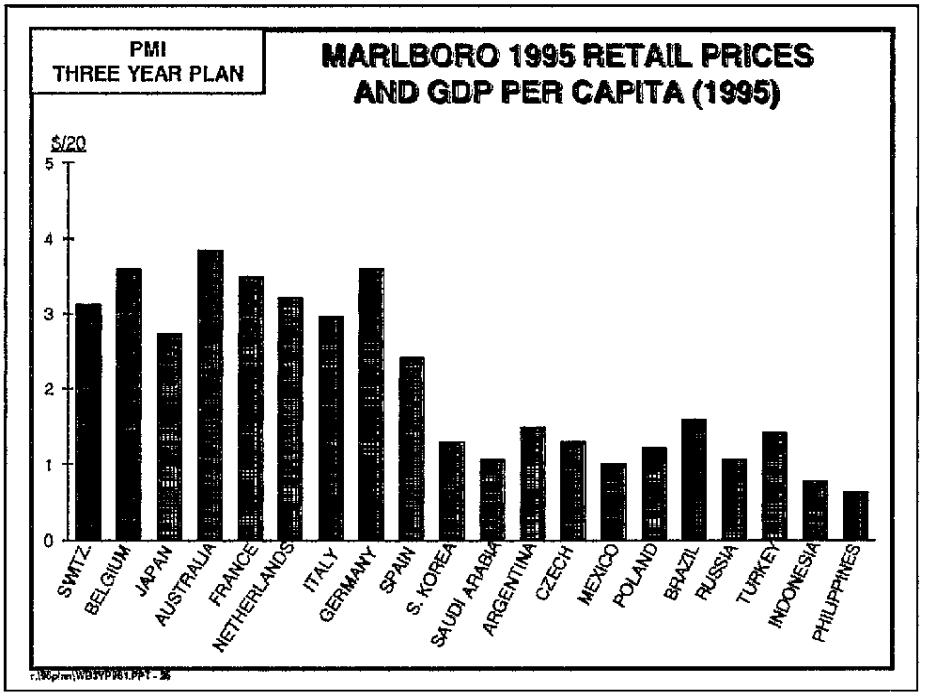
Source: https://www.industrydocuments.ucsf.edu/docs/jgpx0003



- This chart shows the retail prices of Marlboro in dollars for a pack of 20, across our major markets.

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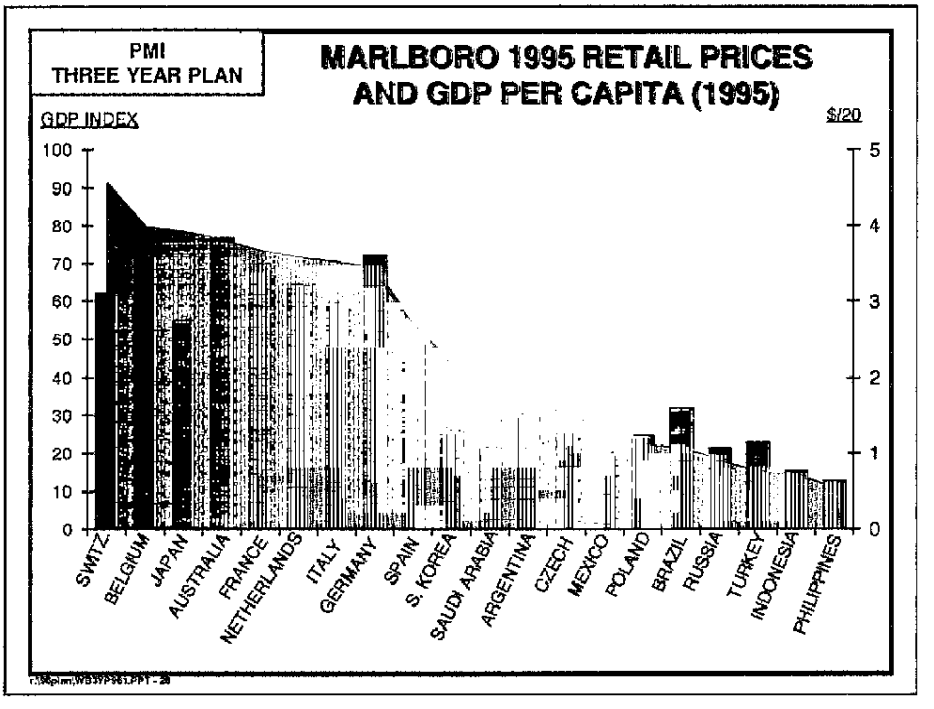
Source: https://www.industrydocuments.ucsf.edu/docs/jgpx0003



- This chart compares the retail prices for Marlboro in $ for a pack of 20 with the GDP per capita index from earlier charts.

- The chart indicates that we are broadly pricing in line with purchasing power across the world, pricing higher in the established richer countries and pricing lower in the developing ones.

- Japan is interesting because here we have the less control.

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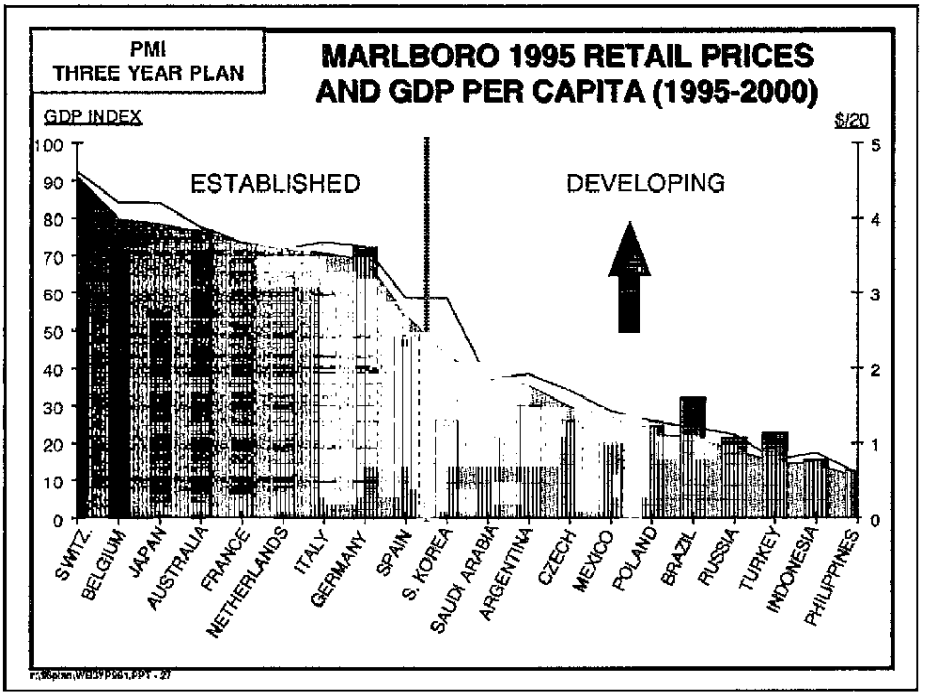
Source: https://www.industrydocuments.ucsf.edu/docs/jgpx0003



- With the purchasing power improvements foreseen for the developing countries, shown in yellow, we should have the opportunity to price up and generate incremental IFO in these markets.
- Japan and South Korea are low relative to GDP. This gives us some confidence that our price increases will be accepted by consumers.

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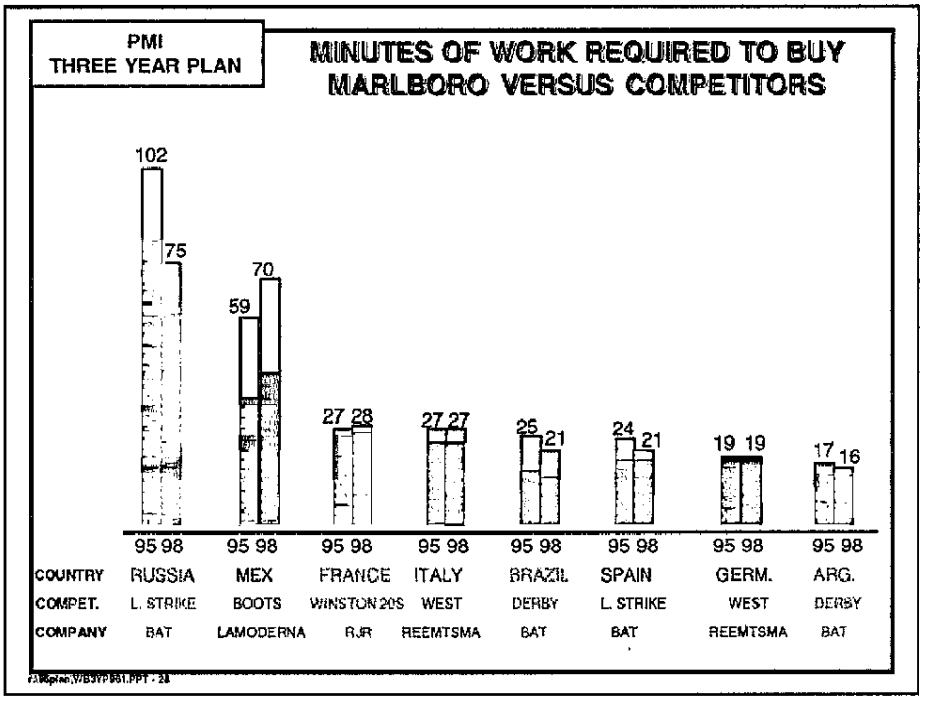
Source: https://www.industrydocuments.ucsf.edu/docs/jgpx0003



- This chart shows the number of minutes of work required to purchase one pack of Marlboro, and compares this with competitor brands.
- In most of our markets Marlboro will become more affordable and we will either maintain the same "gap" between our competitors, or close it over the plan period.
- We expect that the number of minutes required to buy Marlboro will fall significantly in Russia.
- In France, the minutes of work required will increase, due to our having to price above inflation to limit the risk a tax increase.
- We will narrow the gap with our competitors in Spain.
- In Mexico, where we do not have control of our pricing, the number of minutes required will increase significantly.

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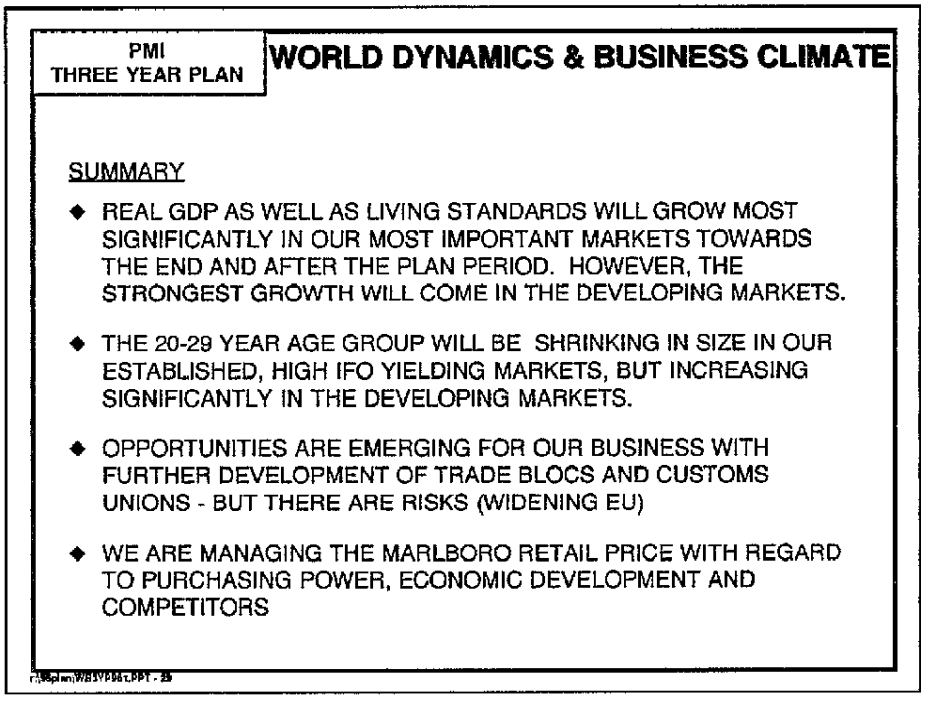
Source: https://www.industrydocuments.ucsf.edu/docs/jgpx0003



- In summary then

"Read Chart"

- John will now take us through the plan numbers and strategies in more detail. John.....

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Source: https://www.industrydocuments.ucsf.edu/docs/jgpx0003